CRIC's reply to the Questionnaire by the High-Level Expert Group on the sustainable finance interim report

Question 1. *From your constituency's point of view, what is the most important issue that needs to be addressed to move towards sustainable finance? (sustainable finance being understood as improving the contribution of finance to long-term sustainable and inclusive growth, as well as strengthening financial stability by considering material environmental, social and governance factors)*

CRIC: There is the need for an ambitious and overarching strategy. Basis for this must be a broad and comprehensive definition of sustainability and ESG.

The report refers to ESG and sustainability but does not provide a definition. Moreover, it mainly elaborates on finance for climate, secondly for environmental issues such as biodiversity loss, natural resource depletion and pollution prevention including climate, and then to a much lesser extent when combining social issues with environmental or green ones. The report proposes a broad set of relatively concrete steps with regards to the Paris Agreement but rarely addresses the commitment to promote the SDGs. Furthermore, it contains hardly proposals for concrete measures on how to promote the social needs of the EU such as unemployment, inequality and the lack of economic and social cohesion.

It is emphasized repeatedly throughout the report that ESG aspects should be integrated into decision making and investment processes if they are material. However, the concept of materiality does as such not help to address the challenges caused by social and environmental externalities. The economic concept of materiality is deficient from an ethical point of view and should therefore be overcome in favour of an orientation towards what is necessary in social and environmental terms.

The following questions cover selected areas that are addressed in the recommendations (chapter VI) of the interim report, which the expert group considers to be crucial and would appreciate your feedback on:

Develop a classification system for sustainable assets and financial products

Question 2. *What do you think such an EU taxonomy for sustainable assets and financial products should include?*

CRIC: The taxonomy should cover a wide range from broad ESG integration strategies to ambitious definitions. Approaches only taking sustainability into account if there is a clear link to the financial performance should receive the lowest score whereas those based on a comprehensive definition of sustainability (including social, cultural and environmental aspects) and prioritising sustainability over financial considerations should have the highest ranking.

In the light of ecological and notably social challenges of today, it is not ambitious enough to start with an initial focus on climate change, continue with other environmental aspects and then include the social dimension only as a third and not yet explicitly planned step. In fact, much work has been done in this regard ranging from social impact investment, to social (impact) and SDG bonds, thematic funds addressing social issues, investment guidelines and benchmarks for human and labour rights to corresponding initiatives and SDG investing strategies. All these experiences should feed into the development of the classification system from the very beginning.

It is not only that climate change is by no means the only environmental challenge. The taxonomy should ensure that sustainability 'as a whole' is addressed which includes economic, environmental and social issues – also known as the 'three pillars of sustainable development'.

Establish a European standard and label for green bonds and other sustainable assets

Question 3. *What considerations should the EU keep in mind when establishing a European standard and label for green bonds and other sustainable assets? How can the EU ensure high-quality standards and labels that avoid misuse/green-washing?*

CRIC: For green bonds, the following should be taken into consideration:

1. Disclosure and transparency are central prerequisites but as such not sufficient. It is vital to develop comprehensive and robust quality criteria for the use of proceeds which should be reviewed by a third party and officially assured as green.
2. Green should not only be understood as referring to climate change but to environmental issues in a comprehensive sense.
3. Green investments are related to social issues too. For instance, recent studies have shown that especially in large-scale renewable energy projects human rights violations are still regularly observed. In this regard, the methodology needs to ensure that the financed projects do not cause social harm.
4. The issuer of the Green Bond Label should be independent.

Standards and labels for other products such as investment funds are welcome. The criteria for them need to be developed on basis of a broad and comprehensive definition of ESG/sustainability (see question 2). In addition to Green Bond Labels, Social Bond and SDG Bond Labels should be developed in parallel building on the experiences already made in this area. Due to the heterogeneity of sustainable investment approaches and the fact that various challenges with different backgrounds require specific solutions, standards and labels for other products should be defined as minimum standards and then continually enhanced.

Create "Sustainable Infrastructure Europe" to channel finance into sustainable projects

Question 4. *What key services do you think an entity like "Sustainable Infrastructure Europe" should provide, more specifically in terms of advisory services and connecting public authorities with private investors?*

CRIC: Such an entity will need to be well-designed and well-thought to ensure that it really contributes to deliver on project finance needed to meet the objectives resulting from the EU's commitments towards the SDGs and the Paris Agreement. As such, the report conceptualises it as a 'facility between public authorities and private investors' which means that it is intended to facilitate mainly large-scale public private partnership projects. Indeed, this seems to be an important lever for channelling finance into sustainable projects.

However, against the backdrop of evidence that the true costs of public private partnership projects are often hidden, the conceptualization and processes of such an entity should be considered and prepared particularly careful. For instance, it should be considered to define independently assessed pre-feasability studies to calculate the true costs and benefits of such projects over the lifetime as a prerequisite in the contract management process. In general, disclosure and cost transparency should play a central role.

The report also touches upon areas for further analysis. The following questions focus on a selection of these, which the group would appreciate your feedback on:

Mismatched time horizons and short-termism versus long-term orientation

Question 5. *It is frequently stated that the inherent short-termism in finance, especially financial markets, represents a distraction from, or even obstacle to, a long-term orientation in economic decision-making, including investments that are essential for sustainability. Do you agree with this statement?*

- *Yes*
- *No*
- *Don't know / no opinion / not relevant*

CRIC: Yes.

Question 5.1. *If you agree with this statement, which sectors of the economy and financial system are particularly affected by the 'mismatch of time horizons'? What are possible measures to resolve or attenuate this conflict?*

CRIC: Undoubtedly, there is a need to overcome short-termism and to develop and strengthen an economic and finance strategy oriented towards long-term sustainable development. Nevertheless, it would be misleading to consider long-term strategies per se as sustainable. Under the condition of an economy with externalities, a long-term approach can still be successful and stable within itself whilst causing harm to the society and/or the environment. For instance, long-term oriented growth based on the depletion of natural resources is even worse than its short-time equivalent. Because of this, a long-term oriented economic and finance strategy needs to be firmly anchored in a broader 'sustainability first' approach with strong objectives considering social, environmental as well as cultural aspects.

Governance of the investment and analyst community

Question 6. *What key levers do you think the EU could use to best align the investment and analyst community with long-term sustainability considerations in the real economy?*

CRIC: The five proposed measures by the HLEG for "Governance of firms and financial institutions" seem promising. This are (1) defining European directors' duties that incorporate value creation for the long-term and sustainability; (2) requiring suitable sustainability expertise on the governing bodies of asset owners above a particular size threshold; (3) developing a set of European corporate governance principles that address long-term value creation and sustainability and reviewing the potential to incorporate long-term value creation and sustainability as part of the incentive framework in regulated industries; (4) developing a set of European stewardship principles (building on established principles) that incorporate active ownership and long-term value creation; (5) requiring consultation with clients and beneficiaries about their ESG preferences.

However, these measures can only become fully effective if their implementation is based on a broad and ambitious definition of sustainability that overcomes the explicit and pure concept of materiality (see answer to question 1) and a profound and continued training on sustainability aspects is ensured (see answer to question 13).

A strong pipeline of sustainable projects for investment

Question 7. *How can the EU best create a strong and visible pipeline of sustainable investment projects ready for investment at scale?*

CRIC: The measures here could learn from existing experiences with successful strategies in the member states. For example, the German Renewable Energy Act has done a great deal. In principle, it should be examined whether and to what extent fiscal incentives can be useful.

The recommendation of the HLEG to encourage the member states to develop and implement national capital-raising plans as part of their National Energy and Climate Plans sounds sensible. This idea could be extended to national sustainability strategies and strategies for implementing the UN's SDGs.

The recommendations of the HLEG are a lot about developing aggregation mechanism to bundle small and middle-scale projects to make them sizeable for capital markets. But one should as well take into consideration that certain sustainable enterprises or companies might require small loans or investments and, likewise, some investors or lenders might especially look for these kinds of clients. This means that the recommendations should not only focus on investments of large sums but also take the market for small and middle-scale projects into account.

Regulation might be the right method of choice in some cases, whereas it can have counterproductive impacts in other cases including unintended side effects. In this regard, the legal framework should be carefully examined with a view to where it prevents investments in sustainable projects due to overregulation. The aim must be to make it easier for retail and institutional investors to invest in social or ecological projects and corresponding financial products, even across borders. For this purpose, it may also be necessary to reduce barriers for investments in products from suppliers outside the conventional financial market.

Integrating sustainability and long-term perspectives into credit ratings

Question 8. *What are some of the most effective ways to encourage credit rating agencies to take into consideration ESG factors and/or long-term risk factors?*

Please choose 1 option from the list below

- *Create a European credit rating agency designed to track long-term sustainability risks*
- *Require all credit rating agencies to disclose whether and how they consider TCFD-related*
- *information in their credit ratings*
- *Require all credit rating agencies to include ESG factors as part of their rating*
- *All of the above*
- *Other*

CRIC: Other.

Role of banks

Question 9. *What would be the best way to involve banks more strongly on sustainability, particularly through long-term lending and project finance?*

CRIC: It is very welcome to further analyse how sustainability can be strengthened through better risk assessments and adjustments of (minimum) capital requirements and, more broadly, the integration of sustainability in Basel's three pillars. Taking steps towards a 'brown-penalising' factor in capital requirements sounds promising too.

However, banks should not only be involved more strongly on sustainability when it comes to project finance and long-term-lending. Rather, the question needs to be answered on how to put sustainability at the heart of European banks' business models. In this respect, a lot can be learned from social and ethical banks, organised in associations like GABV or FEBEA, amongst others.

These banks do show best practice in terms of lending activities serving the real economy and contributing to promote a sustainable development and, equally important, in terms of staff trained and sensitized for the social, ecological and cultural dimension of their work. Furthermore, social and ethical as well as some pioneering conventional banks do invest their own assets/proprietary investments according to sustainability criteria.

The HLEG should try to learn from these examples and make recommendations to further disseminate these best practices.

Role of insurers

Question 10. *What would be the best way to involve insurers more strongly on sustainability, particularly through long-term investment?*

CRIC: The proposal to incorporate sustainability into each of the three pillars of Solvency II should be further examined, e.g. lower capital requirements for sustainable long-term investments. But, as stressed in the report, this should not be done at the expense of undermining the stability of the financial system.

In addition, insures should be required to report on sustainability, e.g. following the example of France's Article 173.

Social dimensions

Question 11. *What do you think should be the priority when mobilising private capital for social dimensions of sustainable development?*

It is vital to ensure that mobilising private capital for the social dimension does not replace public money for such objectives. The opportunity private capital offers in that regard should not be used to justify further austerity measures. In addition, it is important to mention that it is not just the question of how more money can be raised for social and environmental projects, but also of the purpose it will be used for. Not every project marketed as 'green' or 'fair' is a sustainable one in a comprehensive sense. It can regularly be observed that a sustainable development is prevented by supporting non-sustainable activities.

Central social challenges of today are job creation, reducing inequality and quality education for all. With a view to both the EU within and beyond its frontiers, the Agenda 2030 should work as a point of reference. The EU has committed itself to the UN's SDGs and should be as serious and ambitious about implementing these as it is with the Paris Agreement.

As outlined above, the social dimension should be incorporated in the HLEG's strategy from the very beginning. This means, amongst other things, that it should be an essential part of definitions, standards and labels. For this, it is not necessary to start from scratch as this work can be built on comprehensive experiences gained from previous years and even decades (e.g. social impact and SDG bonds, social impact investment, labour and human rights standards, benchmarks and guidelines).

Other

Question 12. *Do you have any comments on the policy recommendations or policy areas mentioned in the Interim Report but not mentioned in this survey?*

CRIC: /

Question 13. *In your view, is there any other area that the expert group should cover in their work?*

CRIC:

- Education/training/sensitization: Training and education on sustainability need to be incorporated into the education system at all levels (school, vocational training, university). Almost more important are training measures for the finance industry itself. In addition, targeted sensitization campaigns need to be developed to address retail investors and the society. Education, training and sensitization should be a central component of each part of the HLEG strategy.
- Sustainability rating agencies and specialized NGOs: Companies like oekom research or Vigeo Eiris/imug have been significant for the development of a more ethical and sustainable financial market. It is therefore central to take their experiences and visions into account. The same applies for civil society organisations.
- More comprehensive analysis of institutional and retail investors: Important groups of investors are missing in the report, e.g. foundations, religious institutions, charities, academic institutions, academic institutions and companies in their role as asset owners. These investors are the ‘real asset owners’ and therefore the most important addressees for a cultural chance in finance.
- Fintech: Precisely because Fintech is currently still at an early stage, the time is favourable to stimulate sustainability by means of targeted promotion. The HLEG should explicitly address its potential for sustainability and incorporate appropriate measures in the strategy.